No. 17,037

United States
COURT OF APPEALS
for the Ninth Circuit

BUILDING SYNDICATE COMPANY,
an Oregon Corp.,

Appellant,

v.

UNITED STATES OF AMERICA,

Appellee.

On Appeal from the Judgment of the District Court for the District of Oregon

BRIEF FOR THE APPELLEE

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CITATIONS

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OPINION BELOW

The District Court's findings of fact and conclusions of law (R. 32-39) are not officially reported. The opinion of the District Court (R. 23-32) is reported at 181 F. Supp. 725.

JURISDICTION

This appeal involves federal income taxes for the calendar year 1953, which were paid by the taxpayer at various dates in 1954 and on September 21, 1956. (R. 10-11.) On October 26, 1956, the taxpayer filed its

claim for refund, and on July 18, 1957, it filed an amended claim. This was rejected by the District Director of Internal Revenue on April 2, 1958. (R. 11.) Within the time provided in Section 3772 of the Internal Revenue Code of 1939 the taxpayer brought an action in the District Court for recovery of the taxes paid. (R. 3.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. Judgment was entered on April 14, 1960. (R. 40.) Within sixty days and on May 13, 1960, a notice of appeal was filed. (R. 41.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether the District Court was clearly erroneous in finding, on the basis of conflicting evidence, that the taxpayer (new company) and its predecessor, Building Syndicate, owned the American Bank Building in substance from the year 1927, so that the predecessor company properly took annual depreciation based on its cost and the taxpayer should not be permitted to add to its depreciated basis the amount which it paid in 1945 in satisfaction of a loan represented by the land trust certificates.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

* * * * *

(l) [as amended by Sec. 121(c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation.*—A

reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property.

* * * * *

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *

(26 U.S.C. 1952 ed., Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b)

for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

(26 U.S.C. 1952 ed., Sec. 114.)

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

* * * * *

STATEMENT

During 1927, the Northwestern National Bank of Portland, Oregon, owned a building which it offered for sale through a real estate broker. This broker, George N. Black, paid $10,000 for an option to purchase the property for approximately $2,200,000. In order to facilitate the sale of the building, Black secured a financial commitment from George W. York & Company, Inc., of Cleveland, Ohio, dated June 21, 1927, to underwrite an issue of land trust certificates in the amount of $1,350,000. (R. 4, 33.) Some time after June 21, 1927, George W. York & Company, Inc., associated with it the Union Trust Company of Cleveland for the purpose of carrying out its commitment. (R. 5.)

Building Syndicate, an Oregon corporation, herein sometimes called Syndicate, was organized on August 1, 1927, with an authorized capital of 7,500 shares of

no par common stock. This stock was subscribed at $40 per share or an aggregate of $300,000. George N. Black transferred to Building Syndicate his option to purchase the bank property in payment of $10,000 on his subscribed stock. (R. 33.) The directors of Building Syndicate agreed that the building be held in trust by Security Savings and Trust Company of Portland and the Union Trust Company of Cleveland. The trustees were to issue a lease to Building Syndicate for a term of 99 years renewable forever. The directors of Building Syndicate negotiated a commitment from the Lumbermen's Trust Company to underwrite $750,000 of leasehold bonds to be issued by Building Syndicate. (R. 33-34.)

The purchase of the building and the necessary agreements were approved at a special meeting of the board of directors of Building Syndicate on September 19, 1927. The minutes of the board of directors state (R. 34-35):

> There was thereupon presented to the Board for consideration a form of escrow agreement, dated as of September 19, 1927, proposed to be executed by Northwestern National Bank, Security Savings and Trust Company, Building Syndicate, Lumbermen's Trust Company and a local bank to be named hereafter (said bank when named to act as agent for Northwestern Mutual Life Insurance Company, holder of a present mortgage on the Northwestern Bank Building property), said escrow being directed to Title and Trust Company, and setting forth in detail the amounts of money to be paid by this company for the purchase of said Northwestern Bank Building property, and the amounts of money to be received by this company from the purchasers

of the 1350 land trust certificates, the issue of which has been hereinbefore authorized, and to be received from Lumbermen Trust Company for the purchase of the $750,000.00 par value first mortgage leasehold bonds of this company, a copy of said escrow agreement being hereinafter set forth as Exhibit "D" to the minutes of this meeting.

On motion duly made and seconded, it was unanimously

Resolved, that the President of this company execute in the name of this company and as its act and deed said escrow agreement.

Resolved Further, that the President and Secretary of this company be and they hereby are authorized and empowered to deliver to Title and Trust Company, as escrow holder, all of the instruments provided to be delivered to it under the terms of said escrow agreement.

Resolved Further, that said officers be and they hereby are authorized and empowered to consummate all sales of securities, execute and deliver all documents, receive all considerations for the sale of securities, and make all payments to Northwestern National Bank provided to be made by the terms of said escrow, and to do and perform all other acts required to be done by this company in order to effect the purchase of said Northwestern Bank Building property in time and manner as is provided for by the terms and condition of said declaration of trust, Exhibit "A", said lease, Exhibit "B," said mortgage, Exhibit "C" and said escrow agreement, Exhibit "D."

Pursuant to the terms of the escrow agreement executed about September 30, 1927 (R. 35), the following occurred (R. 5-6):

By deed dated September 16, 1927, the Northwestern Bank Building property was conveyed by

Northwestern National Bank to Security Savings and Trust Company. Under date of August 15, 1927, though actually executed September 30, 1927, Security Savings and Trust Company as trustee and the Union Trust Company of Cleveland as co-trustee, executed an Agreement and Declaration of Trust between themselves and "The Holders of Land Trust Certificates of Equitable Ownership in the Northwestern Building Site Located in Portland, Oregon, Leased to Building Syndicate (an Oregon corporation)." A lease of the property was entered into between Building Syndicate as lessee and Security Savings and Trust Company, trustee, as lessor, the lease being made as of August 15, 1927, though actually signed September 30, 1927. Building Syndicate entered into an indenture with Lumbermen's Trust Company made as of September 1, 1927, to secure an issue of $750,000 first mortgage leasehold bonds.

The property was conveyed to the trustees, for the benefit of the land trust certificate holders, upon payment to the sellers of $2,202,133.07. The sources of these funds were (R. 36):

From Trustee for Land Trust Certificate Holders (Proceeds of sale of 1,350 Land Trust Certificates of Equitable Ownership)	$1,250,000.00
From Building Syndicate (Proceeds of leasehold bonds and stock)	952,133.07
	$2,202,133.07

The board of directors of Building Syndicate changed the name of the property from the North-

western Bank Building to the American Bank Building in 1928. (R. 35-36.)

In 1932 the leasehold bonds of Building Syndicate were in default and a bondholder's committee was organized. In 1943 the bonds were still in default and the trustee of the bondholders foreclosed on Building Syndicate on December 31, 1943. (R. 37.)

On November 9, 1944, a new corporation known as Building Syndicate Company, herein called the taxpayer, was organized. All the assets of Building Syndicate, including the lease on the bank building, were transferred from the trustee of the bondholders to the taxpayer corporation (new company) on December 31, 1944. The acquisition of the assets by the trustee of the bondholders and their transfer to the taxpayer were pursuant to a tax-free reorganization under the Internal Revenue Code. (R. 37.)

The original lease issued to Building Syndicate contained an option in favor of Building Syndicate whereby it could purchase the fee title from the lessor upon written notice. The trust agreement with the trustee also contained the provisions for acquisition of the fee title by Building Syndicate. Pursuant to the option, the taxpayer (new company) paid the required sums and acquired title to the property on October 31, 1945. (R. 37-38.) The funds for such purchase were derived as follows (R. 38):

Proceeds of loan from Prudential Insurance Co. to Building Syndicate Co.	$1,200,000.00

Application of 138 Land Trust Certificates held by Trustee in depreciation fund pursuant to provisions of lease (at $1,050 per certificate)	144,900.00
From Building Syndicate Co. corporate funds	72,600.00
	$1,417,500.00

Through the years 1927-1943, Building Syndicate claimed and was allowed deductions as owner for depreciation of the American Bank Building based on a useful life estimated in 1927 to be 36 years. (R. 9, 36.) For the year 1944, the return filed by Portland Trust & Savings Bank as trustee for the former bondholders of Building Syndicate computed depreciation on the same basis and in approximately the same amount. (Ex. 51-U.) On its tax return for the year 1945, the taxpayer claimed depreciation from January 1, 1945, on the new allocated cost of the building (following the taxpayer's acquisition of legal title). Under these methods the taxpayer and its predecessor had claimed deductions through October 31, 1945, in the total amount of $549,215.08. Computed on the basis of amortization over a 99 year life, the aggregate amortization of the leasehold as of October 31, 1945, would have been only $172,272.65. The excess of deductions taken over what leasehold amortization would have been is $376,942.43, of which $274,784.49 did not result in tax benefit. (R. 9-10, 38.)

When the taxpayer (new company) purchased the title to the building on October 31, 1945, and the land

trust certificates were retired, the taxpayer made an adjustment to the basis of the building. It added to the undepreciated basis of the building the amount of the land trust certificates, and reallocated the total between the land and the building. (R. 37-38.)

For the year 1953 involved here, the taxpayer claimed certain depreciation on the building, contending in the District Court (1) that the amount which it paid in 1945 to acquire title to the property should be taken into account in computing its basis for depreciation of the property, and (2) that its basis in the building should not be reduced by the amounts claimed as depreciation by the taxpayer and its predecessor in excess of amortization of its leasehold cost to the extent that such excess resulted in no tax benefit. (R. 11.)

The District Court found that, during the years 1927 through 1943, Building Syndicate was the owner of the property in question for income tax purposes; that during those years Building Syndicate had properly computed the depreciation allowance based on the total purchase price in 1927 of the depreciable building (R. 39); that the retirement of the land trust certificates (in 1945) was equivalent to refinancing a loan and had no effect on the basis of the property (R. 38); and that the basis for depreciation in the new company (taxpayer) is the same as it was in the old (R. 39).

The District Court dismissed the taxpayer's suit with prejudice (R. 40).

On this appeal, the taxpayer's only contention is that the amount which it paid in 1945 to acquire title to the building should be taken into account in computing its basis for depreciation. (Br. 7.)

SUMMARY OF ARGUMENT

The findings of the District Court that during the years 1927 through 1943 Syndicate was the owner of the property in question for income tax purposes, that it properly computed the depreciation allowance based on the total purchase price of the depreciable building, and that the retirement of the land trust certificates by the taxpayer was equivalent to paying a loan and had no effect on the basis of the property are findings of fact based on evidence which would at most permit conflicting inferences. We submit, therefore, that they are not clearly erroneous, and ought to be considered conclusive here. The District Court, we believe, was wholly correct in its opinion that the instant case is controlled by the general principles announced in *Helvering* v. *Lazarus & Co.*, 308 U.S. 252. The similarity of the facts found in that case and relied upon by the Supreme Court to those in the instant case is striking. Such distinctions as the taxpayer here would draw between its situation and that in *Lazarus* have been held of no significance in the very case upon which the taxpayer relies most heavily.

The taxpayer here is attempting to repudiate a position and a course of action which was admittedly followed to the benefit of its predecessor for 18 years,

whose basis it must take, and which the Internal Revenue Service implicitly approved by a closing agreement attached to the 1927 tax return. This position was that Syndicate owned the American Bank Building from 1927 and was entitled to annual depreciation deductions based on the cost of the building and its estimated useful life of 36 years in 1927. The record is replete with evidence that all concerned understood and intended Syndicate to be the owner of the property from 1927, and the law supports that position. The taxpayer, however, seeing an opportunity to increase its present tax deductions by repudiating that position, now urges that everyone was mistaken during all those earlier years. It says that actually Syndicate was only a lessee and should have been amortizing its 99-year lease; only in 1945 when the taxpayer acquired legal title to the property by paying $1,417,500 for the legal title did it become entitled to depreciate the building itself. But this amount which the taxpayer paid in 1945 and which it now seeks to add to the basis of the property had already been included in the basis and depreciated since 1927; the amount paid by the taxpayer in 1945 represents only the repayment of a loan, which obviously cannot affect the basis of the property. The District Court's holding that the taxpayer thus seeks an unjustified double tax benefit is thereby clearly correct.

The District Court based its opinion on the assumption, to which the taxpayer agrees, that if Syndicate properly claimed and was allowed depreciation on the cost of the building in the years after

1927, then the taxpayer is not entitled to add to the depreciated basis of the building any part of the amount which it paid to acquire legal title in 1945. The taxpayer complains of the District Court's holding that Syndicate properly claimed depreciation after 1927 because it was the owner of the building for tax purposes. Yet it is clear that one who is not technically the owner may nevertheless bear the burden of exhaustion of capital investment. One need not be the holder of legal title or a mortgagor in the classical sense of that word to claim depreciation. Notwithstanding that the instrument under which Syndicate held the property was in format a lease and option to purchase the fee, this Court has held that the holder of property under such an instrument was actually purchasing it from the beginning and was entitled to depreciation for tax purposes, regardless of his classification under rigid principles of property law. This is an application of the basic principle that the substance of a transaction governs for tax purposes.

The record here is replete with documentary and stipulated evidence indicating an intention and understanding by all parties that Syndicate was purchasing the property in 1927. In the face of that evidence, the District Court was not obliged to credit parol testimony to the contrary, some of which was simply self-serving, even if such evidence was admissible, which is doubtful.

ARGUMENT

The District Court was not clearly erroneous in finding, on the basis of conflicting evidence, that the taxpayer (new company) and its predecessor, Syndicate, owned the American Bank Building in substance from the year 1927, so that the predecessor company properly took annual depreciation based on its cost, and the taxpayer should not be permitted to add to its already depreciated basis the amount which it paid in 1945 in satisfaction of a loan represented by the land trust certificates.

A. The findings of the District Court, based on evidence which would at most permit conflicting inferences, are not clearly erroneous, and since they are essentially similar to the findings in Helvering v. Lazarus & Co., 308 U.S. 252, the result here should be controlled by that decision.

The findings of the District Court (R. 38-39) that during the years 1927 through 1943 Syndicate was the owner of the property in question for income tax purposes, that it properly computed the depreciation allowance based on the total purchase price of the depreciable building, and that the retirement of the land trust certificates by the taxpayer was equivalent to refinancing a loan and had no effect on the basis of the property are findings of fact based on evidence which would at most permit conflicting inferences. We submit, therefore, that they are not clearly erroneous, and ought to be considered conclusive here. *Helvering* v. *Lazarus & Co.*, 308 U.S. 252. In the case of *Akron Dry Goods Co.* v. *Commissioner*, 218 F. 2d 290 (C.A. 6th), where the facts were significantly different from those here, the Court of Appeals held also that the findings were conclusive upon review.

The District Court, we believe, was wholly correct in its opinion that the instant case is controlled by the general principles announced in *Lazarus*. The taxpayer there owned a building which it conveyed to a trustee and took back a 99-year lease plus an option to renew and purchase. The Commissioner disallowed the depreciation deduction to the taxpayer on the theory that the right thereto followed legal title. However, the Board of Tax Appeals found that the instrument under which the taxpayer purported to convey legal ownership to the trustee was in reality given and accepted as no more than security for a loan on the property; the "rent" stipulated in the concurrently executed 99-year "lease" back was intended as a promise to pay an agreed 5% interest on the loan; and the "depreciation fund" required by the "lease" was intended as an amortization fund, designed to pay off the loan in 48½ years. The Supreme Court held that the findings were supported by evidence which permitted at most conflicting inferences and were therefore conclusive. As a matter of law, the Court held that the transaction was actually a loan secured by the property involved, and that the taxpayer was entitled to the depreciation deduction. The similarity to the instant case is striking. Upon conflicting evidence which is discussed in detail below, the District Court here found that the taxpayer was the owner of the property during the years 1927 through 1943. (R. 39.) The rent to be paid by Syndicate represented 5½% on the total certificates outstanding at a par value each of $1,000. (Ex. 52-B.)

And the depreciation fund to which Syndicate was contractually obligated to make annual payments was designed to provide a fund to pay off most of its obligation. The only difference between the instant case and *Lazarus* is that here this device was used to finance purchase of the property, which was conveyed to the trustee at Syndicate's instance, whereas in *Lazarus* the taxpayer previously owned the building and itself conveyed the property to the trustee as security for the loan of money.

The taxpayer seizes upon this difference as significant, and relies upon *City Nat. Bank Bldg. Co.* v. *Helvering,* 98 F. 2d 216 (C.A. D.C.), where this difference also existed, in support of its position. However, the very court which decided that case regarded this difference as of no importance, stating (p. 217) that "the facts were in all essential respects identical" to *Lazarus*. The Supreme Court itself granted certiorari in *Lazarus* on the ground of a conflict with *City Nat. Bank Bldg. Co.,* and pointed to the circumstance that the Court of Appeals for the District of Columbia considered the *City Nat. Bank Bldg. Co.* case upon its facts in all essential respects identical to *Lazarus*. The Supreme Court further stated that because of a conflict between the results reached by the Court of Appeals for the District of Columbia and the Court of Appeals for the Sixth Circuit, it had granted certiorari. It then resolved this conflict against the result reached by the Court of Appeals for the District of Columbia. In such circumstances, the District Court was clearly on sound ground in concluding that all aid from the

City Nat. Bank Bldg. Co. case to the taxpayer was destroyed by the Supreme Court in *Lazarus*.

The taxpayer derived its interest in the property from Syndicate through a tax free reorganization under the Internal Revenue Code. (R. 7, 25, 37.) There is and can be no dispute that it inherited Syndicate's basis and whatever basis Syndicate correctly possessed is the taxpayer's basis. Indeed, the issue turns in large part upon a determination of what in fact was Syndicate's basis. As already discussed, the District Court's finding with respect to Syndicate's basis should be conclusive here, since not clearly erroneous.

B. The taxpayer should not be permitted to repudiate a position maintained by its predecessor to its benefit for eighteen years, especially where such repudiation would result in an unjustified double tax benefit

In the consideration of the instant case, it should be kept in mind that what the taxpayer is attempting to do is to repudiate a position and a course of action which its predecessor, Syndicate, admittedly followed to its benefit for 18 years, and which the Internal Revenue Service implicitly approved by a closing agreement attached to the 1927 tax return. (Exs. 50-A and 51-A.) This position, now sought to be repudiated, was that Syndicate owned the American Bank Building from 1927 and was entitled to annual depreciation deductions on its income tax returns based on the cost of the building and the estimated useful life of the building in 1927. (A revenue agent's report

attached to the 1927 closing agreement specifically noted that Syndicate had allocated $1,093,400 as the basis for depreciation of the building.) The record is replete with evidence that everyone concerned understood Syndicate to be the actual owner of the building in 1927, and we believe that the law supports that position. Notwithstanding that its predecessor reaped the benefits of that position, the taxpayer, seeing an opportunity to increase its tax deductions in later years by repudiating it, is here urging that everyone was mistaken during all those years. The true situation, the taxpayer now says, is that Syndicate was merely a lessee during that time, and instead of claiming depreciation based on the cost of the building and its remaining useful life in 1927, it should have been amortizing its 99-year lease; only in 1945, says the taxpayer, when it acquired legal title to the building by paying over $1,417,500 (R. 8) did it become entitled to depreciate the building itself. We submit that the position of the taxpayer here is analogous to that of the taxpayer in *Maletis* v. *United States,* 200 F. 2d 97 (C.A. 9th), certiorari denied, 345 U.S. 924, who set up and asserted the validity of a family partnership when business was profitable, and then attempted to repudiate the validity of the partnership when it suffered a loss. In disallowing the attempted repudiation of the partnership, this Court said (p. 98):

> The Bureau of Internal Revenue, with the tremendous load it carries, must necessarily rely in the vast majority of cases on what the taxpayer asserts to be fact. The burden is on the taxpayer to see to it that the form of business he has

> created for tax purposes, and has asserted in his returns to be valid, is in fact not a sham or unreal. If in fact it is unreal, then it is not he but the Commissioner who should have the sole power to sustain or disregard the effect of the fiction since otherwise the opportunities for manipulation of taxes are practically unchecked. That which best serves the purpose of the tax statute should govern in this field and not the yearly exigencies of this taxpayer.

See also *Phillips* v. *United States,* 193 F. 2d 132, 133 (C.A. 5th), where the court upheld the position that—

> the government takes the taxpayer as he represents himself to be, and he cannot play fast and loose, now you see it, now you don't, with the government.

If the present position of the taxpayer is correct, Syndicate should have deducted a total amount of $172,272.65 during the period 1927-October 31, 1945, by way of amortizing its lease, rather than a total amount of $549,215.08 by way of deductions for depreciation of the building. In pursuance of this theory, the taxpayer contended at the trial that everything which Syndicate deducted over the years in excess of what it should have deducted by way of amortizing its lease should not be applied to reduce the basis in the building. (R. 12.) The taxpayer also claimed that it should be allowed to add to its basis the sum which it paid in 1945 to acquire the legal title to the building. (R. 8.) Upon this appeal, the taxpayer has dropped the contention that its basis should be restored to the extent Syndicate claimed excessive deductions. The taxpayer now contends only that it should

be allowed to add to the basis of the building, as reduced by the year 1944, the amount which it paid in the year 1945 to acquire legal title. (Br. 7.)

While the taxpayer asserts (Br. 30-32) that the addition to its already depreciated basis in the building of the amount which it paid for the legal title to the building in 1945 will not result in a double tax benefit, upon analysis this will be seen to be erroneous. Thus, the balance sheets on Syndicate's tax returns, beginning in 1938 (Ex. 51-B *et seq.*) show that, of the building's stipulated total cost in 1927 of $2,202,-133.07 (R. 6), Syndicate allocated $1,093,400 to the building and $1,097,662.50 to the land.[1] It has depreciated the building by deducting a total of $549,-215.08, leaving a basis still to be depreciated of $544,-184.92. (R. 10.) When the taxpayer purchased legal title to the property in 1945, paying the amount prescribed in the option contained in the lease agreement of August 15, 1927 (R. 8), it allocated so much of that price to the building as to create a new basis of $1,000,779.96 in the building (R. 9). But this amount which the taxpayer paid in 1945 and which it now seeks to add to the basis of the property had already been included in the basis and depreciated since 1927; the amount paid by the taxpayer in 1945 represents

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[1] It is recognized that the actual total of $1,093,400 plus $1,097,662.50 varies slightly from the stipulated cost of $2,202,-133.07.

Beginning with the 1930 return, Syndicate carried the building as an asset valued at $1,101,074.62 (or more due to improvements it had made), and it carried the land at an approximate value of $1,099,000. (Ex. 51-D *et seq.*)

only the repayment of a loan, which obviously cannot affect the basis of the property. *Helvering* v. *Lazarus & Co., supra.* The closeness of the basis allocated to the building in 1927 to that allocated to it in 1945 indicates that what the taxpayer has done in effect is to restore to the basis of the building in 1945 practically everything which has already been deducted by way of depreciation over the years 1927-1944. It now proposes to depreciate that restored basis all over again on an assumed life of 32 years from January 1, 1945. (R. 9-10.) The District Court's holding, on the authority of *Akron Dry Goods Co.* v. *Commissioner,* 18 T.C. 1143, affirmed *per curiam,* 218 F. 2d 290 (C.A. 6th), that the taxpayer seeks an unjustified double tax benefit is therefore clearly correct.

C. The substance of the transaction involved here was that Syndicate was making a capital investment in the building and purchasing it, and the tax consequences should not be based on the technicalities of property law and conveyancing

The District Court grounded its opinion on the assumption that if Building Syndicate properly claimed and was allowed depreciation based on the cost of the building in the years after 1927, then the taxpayer is not entitled to add to the depreciated basis of the building any part of the amount which it paid to acquire legal title in 1945. It is admitted in the taxpayer's argument that this is a correct statement of the issue.[2] (Br. 11-12.) The taxpayer complains, how-

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[2] Implicit in this approach to the case by the taxpayer is the admission that Building Syndicate Company and the taxpayer as its successor have the same basis in this property. (R. 7-9, 25, 37.)

ever, of the court's determination of the issue by inquiring whether or not the taxpayer should be treated as the owner of the building *for tax purposes*. The taxpayer insists that only "property law tests for determining ownership" are relevant. (Br. 12-13.) By this we must suppose that the taxpayer is not insisting that only the holder of legal title to the fee is entitled to be considered the owner, for this would conflict with cases which the taxpayer says are correct, although it erroneously alleges them to be distinguishable from the instant case. (Br. 22-23.) *Helvering* v. *Lazarus & Co.*, 308 U.S. 252; *Commissioner* v. *H. F. Neighbors R. Co.*, 81 F. 2d 173 (C.A. 6th). The taxpayer also seems willing to agree that if it were a mortgagor in the classical sense of the word, it would have been entitled to depreciation. (Br. 14-15.) At the same time, the taxpayer points out that a mere lessee of property, no matter how long the term, is not entitled to depreciation. *Weiss* v. *Wiener*, 279 U.S. 333. What the taxpayer does seem to mean by insisting on "property law tests for determining ownership" is that the court must take the taxpayer's name for its relationship to the property at face, and determine the consequences on that basis: if the relevant instrument says that the taxpayer is the fee owner or a mortgagor, it may take depreciation; if the instrument says the taxpayer is a lessee, it may not. In this the taxpayer has overlooked the well-known principle that in tax matters substance prevails over form,[3] as well

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[3] In *Helvering* v. *Lazarus & Co.*, *supra*, the Supreme Court said (p. 255):

as recent cases involving the transfer of property by lease plus option to the lessee to buy in which this Court has held that a lessee was a purchaser for tax purposes at the time of the transaction, even though the option to buy had not been exercised. *Oesterreich* v. *Commissioner,* 226 F. 2d 798 (C.A. 9th); *Robinson* v. *Elliott,* 262 F. 2d 383 (C.A. 9th). The Court in those cases did not look merely at the labels on the formal documents, but rather at the realities of the transaction determined according to what the parties intended.

In the *Elliott* case, the owner of a building issued to one Buttrey a "Lease Agreement and Option to Purchase" which provided for ten annual payments of $19,000 each as rent with an option at the end for Buttrey to acquire the property for the sum of $75,000. In the ten-year interim Buttrey was to be responsible for all of the usual burdens of the owner such as property taxes, insurance premiums and repairs. On the basis of this agreement alone, without even ruling as to whether parol evidence was admissible, this Court held (p. 385) that the trial court was "justified in recasting the agreement for tax purposes * * * ." The effect of this recasting was to entitle the lessor to

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> In the field of taxation, administrators of the laws and the courts are concerned with substance and realities, and formal written documents are not rigidly binding.

Recently the Supreme Court has again given expression to this principle in *Commissioner* v. *P. G. Lake, Inc.,* 356 U.S. 260, 266-267, saying:

> These arrangements seem to us transparent devices. Their forms do not control. Their essence is determined not by subtleties of draftsmanship but by their total effect.

treat the annual payments of $19,000 which he received as capital gain, and to deprive Buttrey of the right to deduct them as rent. In effect the Court held (and so stated) that Buttrey was making a capital investment. Under such circumstances, this Court has held that a taxpayer also acquires the right to take the depreciation deduction. *Starr's Estate* v. *Commissioner,* 274 F. 2d 294, 295 (C.A. 9th). We see no difference in principle between the agreement in the *Elliott* case and that involved in the case at bar. Both provided for a substantial option price to be paid before the lessee would acquire title; both placed all the burdens of ownership on the lessee;[4] in neither could the lessee have been neatly categorized in terms of property law as a legal owner or as a mortgagor. As the Court noted in *Elliott* (p. 385):

> No doubt under Montana law the document would be always what it called itself: "Lease Agreement and Purchase Option."

For purposes of tax law, however, the document was held to be what it was in substance. In the case at bar, where everyone concerned seemed satisfied for 18 years that the substance of the arrangement under which Syndicate held the American Bank Building entitled it to the depreciation deduction, the taxpayer's present attempt to repudiate that by reliance upon rigid principles of conveyancing and property law seems particularly inapproriate.

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[4] See Ex. 7, Article Five.

D. The documentary evidence demonstrates the intention of the parties that Syndicate was purchasing the property and was in fact the owner of it from the time of the 1927 transaction

Although the taxayer admits that its present position is inconsistent with Syndicate's previous tax returns, its corporate minutes, and accounting records (Br. 18-19), we deem it important to call such parts of these documents to the Court's attention as will show that this was not an arrangement by which Syndicate simply became the lessee of property with an option to buy if it chose. On the contrary, these records show that the whole transaction was set in motion by Syndicate as assignee of an option to *buy* the property from the Northwestern National Bank (Ex. 2 (corporate minutes), pp. 14-15; see R. 99), and that its intention was to buy the property. All the other parties eventually involved in the arrangement including George W. York & Company, Union Trust Company of Cleveland, Security Savings and Trust Company, Lumbermen's Trust Company, and the holders of land trust certificates, were in it only for financing purposes (R. 4-6). Syndicate's corporate minutes show that its board of directors was urging that "the subscriptions to capital stock of this company be paid in cash in full on or before September 1, 1927, in order to provide funds with which to effect the purchase of the Northwestern Bank Building property * * * ." (Ex. 2, p. 19.[5]) The minutes also referred

[5] Actually some $200,000 of Syndicate's own cash went into the purchase of the property in 1927. The record shows that Syndicate provided $952,133.07 toward the purchase price from

to the escrow agreement (which is now missing and not a part of this record) as "setting forth in detail the amounts of money to be paid by this company for the purchase of said Northwestern Bank Building property * * * ." (Ex. 2, p. 34.) Again, the minutes of September 27, 1927, state the following (Ex. 2, pp. 36-37):

> The president then stated to the directors that the meeting had been called for the purpose of informing the stockholders as to the actions taken by the directors and officers of the company relative to the purchase of the Northwestern Bank Building property and the completion of the financing connected therewith.

And further (Ex. 2, pp. 37-38):

> that the stockholders of this company do hereby ratify and approve all actions taken by the Board of Directors of this company and under the authority of the Board of Directors by the officers of this company in executing documents, receiving consideration for the sale of securities, and making payments to the Northwestern National Bank required to be made by this company in connection with the purchase by this company of the Northwestern Bank Building property in Portland.

Syndicate's proposed depreciation and amortization entries as of December 31, 1927, plainly demonstrate that it thought it had purchased the property. (Ex. 54-A.) It allocates to the building 49.7% of the total consideration paid ($1,093,400), refers to the *purchase*

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the proceeds of sale of leasehold bonds and of stock. (R. 6.) Since the bonds were issued in the aggregate amount of $750,000 (R. 6), the difference of $202,133.07 must have been Syndicate's capital acquired by the sale of its stock.

of the building by Building Syndicate, and states that—

> The period of 3 months ownership by Building Syndicate is ¼ of $30,372.22 or $7,593.05: Depreciation Reserve to December 31, 1927.

Thereafter, as noted above, Syndicate carried the building on its balance sheets (as contained in its tax returns) as an asset valued at $1,093,400 or more, and claimed annual depreciation thereon of $30,372.20 or more until 1944. (Exs. 51-C—51-U.) And, as the District Court found, in each of its returns through 1942, Syndicate stated its business as "Owns and Operates Office Building", or "Building Ownership", or "Building Owner", while the land trust certificates and leasehold bonds were carried as corporate liabilities. (R. 36-37.) Syndicate's returns from 1928 through 1931 further show that the annual rental payable by Syndicate was deducted under the heading of "Interest Expense". (Exs. 51-B—51-E.) The annual report of Syndicate's independent accountants dated December 31, 1928, also shows that this annual rental was regarded as interest expense representing 5½% on the total land trust certificates outstanding at a par value each of $1,000. (Ex. 52-B.) This same annual report of the accountant stated on page 1:

> This corporation owns the American Bank Building, the management of which is with the Strong & McNaughton Trust Co.

On page 2, the report further shows:

> FIXED ASSETS—The purchase of the building and building site of the American Bank Building was made at cost of $2,200,000.00.

As a further indication of the purpose of this whole transaction to result in Syndicate's purchase of the property and not its mere leasing thereof, we call attention to the requirement in Article Three of the Indenture of Lease (Ex. 7, pp. 7-10) that Syndicate set up a depreciation fund in the sum of $1,200,000, and pay into it annually for the first 10 years $6,750, and thereafter $10,000 per year. Article Four of the lease provides that the amounts in this fund should, upon Syndicate's decision to exercise its option to purchase the fee title, be credited on such purchase price. On the other hand, if the lease expired for any reason and Syndicate had not exercised its option, the fund was to become the property of the trustee. Thus, the longer Syndicate paid these required amounts into the depreciation fund, the more likely it was to exercise the option rather than forfeit the fund to the trustee. If the fund in fact were ever to have become fully paid up in the amount of $1,200,000 as contemplated, it would have lacked only $217,500 of covering the entire option price of $1,417,500, and Syndicate would hardly have considered forfeiting it. Cf. *Oesterreich* v. *Commissioner, supra; Commissioner* v. *H. F. Neighbors R. Co.,* 81 F. 2d 173, 175 (C.A. 6th). Thus, the creation of this fund was plainly a part of the arrangement under which Syndicate was contractually obligated to put aside funds which would eventually be used to pay off the loan made to it.[6]

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[6] It should be noted, however, that where property is pledged as security for the payment of a debt, the pledgee or mortgagee is considered a creditor regardless whether the

We may also note, as an indication of Syndicate's relationship to the property, that in event of condemnation of substantially all of the premises, Syndicate was to be entitled to the entire amount of damages upon its payment of the option price. (Ex. 7, p. 13.)

We submit that the inevitable conclusion to be drawn from this array of documentary evidence is that the whole purport and intention of the arrangement was to finance Syndicate's purchase of the bank building. The taxpayer insists that no loan was ever contemplated and that neither Syndicate nor its successor was a mortgagor. But there are other types of security arrangements for financing the purchase of property, the result of which is the same and the tax consequences of which should also be the same. The fact that Syndicate may have forfeited the property upon its failure to keep up the payments and that the arrangement provided no right of redemption does not prove that Syndicate was not purchasing the property. It merely shows that Syndicate was not a mortgagor in the classical sense. Moreover, it is interesting to note that in 1933, when Syndicate became unable to keep up its annual payments, the property was not in fact forfeited, and ultimately, after its tax free reorganization in 1944, Syndicate's successor, the taxpayer, did acquire the legal title as contemplated from the beginning.

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pledgor or mortgagor is personally obligated to pay the debt. *Woodsam Associates* v. *Commissioner,* 198 F. 2d 357 (C.A. 2d); *Prater* v. *Commissioner,* 273 F. 2d 124 (C.A. 5th); *Commissioner* v. *H. F. Neighbors R. Co.,* 81 F. 2d 173 (C.A. 6th).

The taxpayer's answer to this documentary and stipulated evidence tending to show that the whole purport of the transaction was a purchase of the property by Syndicate is that the parol testimony of three witnesses is to the contrary, and that in any event, these documents are not evidence of the intent of the trustee. This Court has displayed a wariness of relying on parol testimony in cases of this kind (*Robinson* v. *Elliott, supra*), and the trial court also was reluctant to afford it reliance here. (R. 28-29.) The trial court did not consider it convincing in the light of the documentary evidence, and was obviously not obliged to credit it. *Hann* v. *Venetian Blind Corp.,* 111 F. 2d 455, 460 (C.A. 9th); *Midland Ford Tractor Co.* v. *Commissioner,* 277 F. 2d 111, 115 (C.A. 8th); *Winters* v. *Dallman,* 238 F. 2d 912, 914 (C.A. 7th); *Anderson* v. *Commissioner,* 250 F. 2d 242, 246-248 (C.A. 5th), certiorari denied, 356 U.S. 950; *Associated Press* v. *KVOS,* 80 F. 2d 575 (C.A. 9th). Here the taxpayer relies upon the self-serving testimony of its present president, the gist of which was that, although the corporate minutes show that Syndicate was buying the property in 1927, those minutes and all the other documents so indicating are erroneous. The witness testified (R. 103) that A. R. Watzek, president of Building Syndicate, "never had any idea that we owned this property or that we had had a liability * * * "; But A. R. Watzek was not called by the taxpayer to testify. The testimony of William L. Brewster, secretary-treasurer of the taxpayer, was wholly innocuous.

The taxpayer further argues that the documents in evidence at most show only Syndicate's unilateral intention, and not that of the trustee. (Br. 20.) But the taxpayer did not submit any documents showing how the trustee treated the transaction on its books. Amis C. Coney, who was a vice-president of the trustee at the time of the transaction, testified that there was no indebtedness on the part of Syndicate; but this is no substitute for the trustee's records showing how it treated the transaction. The witness stated that Syndicate did not have a mortgagor's right of redemption (R. 120); we have already pointed out that this was not a mortgage in the classical sense, and not every purchase of property by means of a security transaction need involve all the characteristics of a classical mortgage. It is obvious, as the witness testified (R. 118-119), that the trustee held the fee title and that Syndicate was not required to exercise its option. None of this vitiates the basic and elementary facts that the whole transaction was undertaken pursuant to the exercise of an option to buy held by Syndicate—not by the trustee—and that the trustee was a party to the lease which itself represents strong evidence of the intention of the parties that Syndicate was buying the property. Furthermore, it is a great deal more indicative of the trustee's intention and understanding of this transaction that neither it nor the holders of the certificates claimed any deduction for depreciation of this building in the years after 1927. Obviously the Internal Revenue Service would have not allowed such depreciation both to Syndicate and the trustee.

The taxpayer also argues that at every instance where the trustee had an opportunity to evidence its intent, it took the position that the transaction was not a mortgage and that Syndicate was merely a lessee. In support of this it cites a request in 1938 that the Syndicate's balance sheet be changed to show that Syndicate held a leasehold. (Br. 21.) Exhibit 16 shows, however, that on its balance sheet of June 30, 1938, Syndicate continued to carry in its asset column the "Land at Cost" in the amount of $1,099,-733.07, and the "Building at Cost less Reserve for Depreciation of $325,733.60" in the amount of $767,-666.40 (representing a total undepreciated cost of $1,093,400). Perhaps Syndicate changed the title of the column; but the substance of it remained that the land and the building were assets belonging to Syndicate.

Syndicate and its successor, the taxpayer, clearly had a capital investment in the building. That capital investment having been depreciated since 1927, the taxpayer plainly cannot add to its depreciated basis an amount paid merely in satisfaction of its indebtedness.

CONCLUSION

The judgment of the District Court should be affirmed.

Respectfully submitted,

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